No. 85-568 (3)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,
Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, *Attorney General, et al.,*
Appellees.

On Appeal from the Supreme Court of North Carolina

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* AND BRIEF OF EDISON ELECTRIC INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF THE JURISDICTIONAL STATEMENT

ROBERT L. BAUM
Counsel of Record
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-7400

RICHARD M. MERRIMAN
ROBERT S. WATERS
Suite 1100
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-0100

Attorneys for Edison Electric Institute

Of Counsel:

REID & PRIEST

October 1985

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

30 P

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No.

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,
Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, *Attorney General, et al.,*
Appellees.

On Appeal from the Supreme Court of North Carolina

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

Pursuant to Rules 36 and 42 of the Rules of the United States Supreme Court, the Edison Electric Institute (EEI) respectfully moves for leave to file the attached brief as *amicus curiae.*[1]

---

[1] While some parties have consented to the filing of the attached brief as *amicus curiae,* various other parties have not consented to EEI's participation. The letters providing consent have been filed with the Clerk of the Court.

SPECIAL INTEREST OF EDISON ELECTRIC INSTITUTE

EEI is the national association of investor-owned electric utility companies in the United States. EEI's members, in significant contrast to the Aluminum Company of America (Alcoa), obtain substantially all, if not all, their operating revenues and income from sales of electricity to consumers at rates regulated by state commissions (or local regulatory bodies) and the Federal Energy Regulatory Commission (FERC). At the retail level, EEI's members conduct their businesses in accordance with the broad duty of public utilities to serve the public.

Central issues in the decision below involve the relationship, consistent with federal preemption doctrine, between the separate powers of the FERC and the North Carolina Utilities Commission (NCUC) to regulate electric rates, and limitations imposed by the Commerce Clause of the United States Constitution on the power of the state of North Carolina to regulate the economic benefits of hydroelectric power generated within its borders. These issues are vitally important to electric utility companies and their customers, and the final opinion in the case may become a significant and far-reaching precedent.

Alcoa owns two companies which generate electric power within the state of North Carolina for sale in interstate commerce. These companies were parties to the rate proceedings before the NCUC giving rise to this case. Unlike EEI's member companies, however, Alcoa is not primarily in the business of owning properties to generate electricity for sale to the public pursuant to federal and state rate regulation. Instead, Alcoa obtains practically all its revenues and income from the

production and sale of aluminum products. Since the production of aluminum requires large amounts of electric power, Alcoa is principally a consumer of electricity, not a producer.

Therefore, EEI is in a unique position to approach the issues from the perspective of electric utilities and their customers, which have a vital interest in the outcome. The attached brief as *amicus curiae* demonstrates that the questions arising in the case are substantial and may seriously affect the regulatory domain of electric utilities and their customers.

CONCLUSION

For the reasons set forth above and in the attached brief, EEI urges the Court to grant its motion for leave to file the attached brief as *amicus curiae*.

Respectfully submitted,

ROBERT L. BAUM
Counsel of Record
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-7400

RICHARD M. MERRIMAN
ROBERT S. WATERS
Suite 1100
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-0100

Attorneys for Edison Electric Institute

Of Counsel:
REID & PRIEST

October 1985

QUESTIONS PRESENTED

Whether a decision of the North Carolina Utilities Commission violates federal preemption by requiring an allocation of power supply costs incurred pursuant to rate schedules subject to regulation under the Federal Power Act in a manner different than that found just and reasonable by the Federal Energy Regulatory Commission.

Whether the same decision violates the Commerce Clause of the United States Constitution insofar as it gives retail electric customers located in North Carolina a preference over an out-of-state customer to the economic benefits of hydroelectric power generated within North Carolina.

TABLE OF CONTENTS

	Page
Questions Presented	i
Table of Authorities	iii
Parties To This Proceeding	1
Opinion Below	1
Jurisdiction	2
Constitutional and Statutory Provisions	2
Interest of Edison Electric Institute	2
Statement of the Case	3
I. The Questions Presented Are Substantial	3
II. The Decision Below Is Inconsistent With Preemption Doctrine	5
III. The Decision Below Violates The Prohibition Against Undue Interference With Interstate Commerce	16
Conclusion	20

TABLE OF AUTHORITIES

Cases:	Page
Arkansas Electric Cooperative Corp. v. *Arkansas Pub. Serv. Comm'n,* 461 U.S. 375 (1983)	19
FPC v. *Florida Power and Light Co.,* 404 U.S. 453 (1972)	6
FPC v. *Southern California Edison Co.,* 376 U.S. 205 (1964)	14
Middle South Energy, Inc. v. *Arkansas Pub. Serv. Comm'n,* Nos. 84-2409, 84-2410, 84-2480 (8th Cir. August 23, 1985)	16, 18, 19
Naragansett Electric Co. v. *Burke,* 119 R.I. 559, 381 A. 2d 1358 (1977) *cert. denied,* 435 U.S. 972 (1978)	8
New England Power Co. v. *New Hampshire,* 455 U.S. 331 (1982)	*passim*
Northern States Power Co. v. *Hagen,* 314 N.W.2d 32 (N.D. 1981)	10, 11, 17
Northern States Power Co. v. *Minnesota Pub. Util. Comm'n,* 344 N.W.2d 374 (Minn.) *cert. denied,* 104 S.Ct. 35-3 (1984)	10, 11, 17
Office of Public Counsellor v. *Indiana and Michigan Electric Co.,* 416 N.E.2d 161 (Ind. App. 1981)	13, 17
Pike County Light and Power Co. v. *Pennsylvania Pub. Util. Comm'n,* 465 A.2d 735 (Pa. Commw. Ct. 1983)	13
Pub. Serv. Co. of Colorado v. *Pub. Util. Comm'n of Colorado,* 644 P.2d 933 (Colo. 1982)	10
Sinclair Machine Products, Inc. v. *Pub. Util. Comm'n of New Hampshire,* No. 84-380 (N.H. July 26, 1985)	13, 14
United Gas Corp. v. *Mississippi Pub. Serv. Comm'n,* 240 Miss. 405, 127 So.2d 404 (1961)	13

Page

Washington Gas Light Co. v. *Pub. Serv. Comm'n of District of Columbia,* 452 A.2d 375 (D.C. App. 1982), *cert. denied,* 462 U.S. 1107 (1983) 10

CONSTITUTION:

U.S. Const., art. I, § 8, cl. 3 4

STATUTES:

28 U.S.C. § 1257(2) (1982) 2

Federal Power Act, 16 U.S.C. §§ 824-824k (1985) 4

ADMINISTRATIVE DECISIONS:

Nantahala Power and Light Co., Opinion No. 139, 19 F.E.R.C. ¶ 61,152 (1982) *aff'd, Nantahala Power and Light Co.* v. *FERC,* 727 F.2d 1342 (4th Cir. 1984) 7

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No.

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,
Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, *Attorney General, et al.,*
Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF OF EDISON ELECTRIC INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF THE JURISDICTIONAL STATEMENT

PARTIES TO THIS PROCEEDING

The parties to this proceeding are set forth in the Jurisdictional Statement.

OPINION BELOW

The opinion below is reproduced in the Appendix to the Jurisdictional Statement and reported at 313 N.C. 614.

JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. § 1257(2) (1982).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The constitutional provisions involved are reproduced in the Jurisdictional Statement and the statutory provisions involved are reproduced in the Appendix to the Jurisdictional Statement.

INTEREST OF EDISON ELECTRIC INSTITUTE

Edison Electric Institute (EEI) is the national association of investor-owned electric utility companies in the United States. Its members serve approximately 96 percent of all customers of the investor-owned segment of the electric utility industry and 73 percent of the nation's electricity users.

Many EEI members obtain a portion of their total supply of electrical capacity and energy (power) available to sell to their retail customers through interstate, wholesale purchases from other utilities or from generating companies at rates regulated exclusively by the Federal Energy Regulatory Commission (FERC). For example, some EEI members have entered into wholesale purchase agreements with neighboring utilities. Additionally, a significant number of EEI's members participate in interstate, multiparty power pools which include provisions for reciprocal wholesale sales and exchanges of power; others have invested in electrical generation projects that are jointly owned by utilities with separate retail service areas. These base-load, generating projects also typically involve large, wholesale sales of power.

In these arrangements, ratemaking jurisdiction almost always rests first with the FERC and then with at least one state commission (or local agency) which establishes the retail rates that are necessary to pass through the costs of the wholesale supplies to the ultimate consumers. More than one state commission will be interested in the wholesale arrangement if there are several purchasers with service areas in different states. Therefore, many EEI member companies are exposed to a blend of regulation that includes the FERC and at least one state commission but, quite possibly, may include two or more state commissions. This blend of regulation has created serious ratemaking conflicts.

The amount of power available for retail consumers that is supplied by arrangements involving wholesale purchases is enormous and will continue to increase. The costs associated with the largest of these wholesale arrangements, which sometimes have expected durations of approximately 30 years, may be measured in billions of dollars, and the planning involved to complete large projects consumes many years. The allocation of responsibility for these costs will be affected by any significant decision involving the reconciliation of federal and state utility ratemaking jurisdictions or the power of a state to regulate the economic benefit of power resources within its borders.

STATEMENT OF THE CASE

EEI adopts the Statement of the Case presented in the Jurisdictional Statement.

I. The Questions Presented Are Substantial.

In recent years as the costs associated with interstate, wholesale purchases have risen dramatically, im-

portant questions concerning the reconciliation of the FERC's wholesale ratemaking jurisdiction under Part II of the Federal Power Act, 16 U.S.C. § 824-824k (1985) (the Act), with the role of state or local regulatory agencies already have been presented in various regions of the nation and undoubtedly will be addressed in the future in other regions. Resolution of these questions will affect the manner in which costs are distributed among different groups of customers, who will be taking service in many instances from utilities located in different states and subject to the retail ratemaking authority of different regulatory bodies.

In the case below, the Supreme Court of North Carolina has determined that, for the purpose of establishing retail rates, the North Carolina Utilities Commission (NCUC) was not preempted from adopting its method for allocating wholesale power costs between customers in the states of North Carolina and Tennessee in a manner different from that allocated by the FERC in establishing wholesale rates, nor was the NCUC's order unduly burdensome on interstate commerce in violation of the Commerce Clause of the United States Constitution. U.S. Const., art. I, § 8, cl. 3 (the Commerce Clause). The court correctly stated that the decision involves "substantial questions under the federal constitution." 313 N.C. at 624.

Left standing as is, the decision threatens the ability of utilities purchasing bulk power supplies under rates set by the FERC to obtain or maintain stable and rational cost allocation plans at the state level. This situation will be particularly acute when ratemaking jurisdiction is not only divided between the FERC and a state commission but instead, among the FERC and more than one state commission. Furthermore, the decision could jeopardize attempts to plan and finance interstate power projects and power pooling agreements that may be needed in the future to meet expected load growth.

II. The Decision Below Is Inconsistent With Preemption Doctrine.

The center of the controversy in this appeal is the NCUC's choice of a method of cost allocation used to establish rates applicable to general retail service provided by Nantahala Power and Light Company (Nantahala) and the effect of that choice on rates applicable to service of a customer in another state. Nantahala and Tapoco, Inc. (Tapoco) are wholly-owned subsidiaries of the Aluminum Company of America (Alcoa), and both are public utilities under the Act. Nantahala and Tapoco are parties to the "New Fontana Agreement" (the NFA) and the "1971 Nantahala-Tapoco Apportionment Agreement" (the 1971 Apportionment Agreement), which together constitute rate schedules subject to the FERC's exclusive rate jurisdiction under the Act (collectively, the Agreements). The FERC-regulated rate schedules provide for Nantahala and Tapoco to deliver certain hydroelectric power to the Tennessee Valley Authority (TVA), and to receive in return certain entitlements to power, that are then apportioned between Nantahala and Tapoco.

Since Nantahala and Tapoco are separate corporations, they have separate generating facilities and separate costs of owning and operating those facilities. Likewise, the power apportioned to each in return for the exchange with TVA is separately recorded as part of each company's own resources. Thus, as recorded on their separate books of accounts, Nantahala and Ta-

poco have their own costs of service. Furthermore, Nantahala's cost of service traditionally has been separately allocated in accordance with authorized methods of allocation in wholesale and retail rate cases before the FERC and the NCUC among the different classes of service provided by the company.

Under the method adopted by the NCUC in the case below, however, Nantahala and Tapoco were first rolled together and a single, combined cost of service was derived. Then, contrary to the request of Nantahala and Tapoco to use a method of allocating this combined cost of service that used the entitlements, and apportionment of such entitlements, as established by the Agreements, the NCUC chose a method of allocation which purportedly assigned cost responsibility to Nantahala and Tapoco "on the basis of which load actually used the capability available from the generating facilities of the combined system." 313 N.C. at 667.[1] The effect of using this method, referred to generally as the "roll-in" method by the lower court, was to produce a lower cost responsibility for Nantahala's general service customers, all of whom are located in North Carolina, and a higher cost responsibility for Tapoco, which only serves Alcoa's industrial load in the state of Tennessee.

As the lower court recognized, objection to the NCUC's decision to use the so-called roll-in method

[1] The lower court's description of the method of allocation chosen by the NCUC is misleading. Due to the inherent characteristics of electricity flowing in a transmission grid, it is impossible to know which loads actually used which capability. *FPC* v. *Florida Power and Light Co.*, 404 U.S. 453 (1972). *Accord, New England Power Co.* v. *New Hampshire*, 455 U.S. 331, 334 (1982). Thus, the relevant point is that the NCUC chose a different method of cost allocation than one consistent with the Agreements.

lies not only with the roll-in itself but with the related cost allocation method used to apportion the combined costs between Nantahala and Tapoco. 313 N.C. at 667.[2] For example, as asserted by the appellants, the worst aspect of the NCUC's cost allocation method is its use of an assumed level of entitlements that exceed actual entitlements under the NFA. Jurisdictional Statement at 10-11. The important and undisputed point for the purpose of this brief is that the NCUC's method did not follow the FERC-regulated rate schedules in choosing a cost allocation method; therefore, cost responsibility was reallocated between Nantahala and Tapoco.

The roll-in method adopted by the NCUC is directly contrary to determinations made when the FERC considered a request for use of a roll-in method in a hearing conducted pursuant to the FERC's exclusive jurisdiction over the Agreements. *Nantahala Power and Light Co.*, Opinion No. 139, 19 F.E.R.C. ¶ 61,152 (1982), *aff'd, Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984). While the FERC adjusted the level of entitlements apportioned to Nantahala and Alcoa under the 1971 Apportionment Agreement, it did not adjust the NFA. Moreover, it expressly rejected a roll-in method because the "separate corporate identities of Nantahala and Tapoco . . . [did not] . . . frustrate the purposes of the Federal Power Act." *Id.* at 61,277.

In its opinion, the North Carolina Supreme Court recognized that the Agreements fall within the "regulatory jurisdiction of the FERC under Part II of the

[2] However, Alcoa alleges that the NCUC used only a partial roll-in which, by assigning responsibility for a higher cost purchase by Alcoa from TVA under a separate agreement entirely to Alcoa, has the effect of biasing the process in favor of Nantahala.

Federal Power Act" (313 N.C. at 684) and that, "the North Carolina Utilities Commission is preempted from directly or indirectly regulating the wholesale rate structure created by the New Fontana and 1971 Apportionment Agreements or inquiring into the reasonableness of those FERC-filed wholesale rate schedules when it acts in fixing Nantahala's retail rates." *Id.* at 687. To avoid the obvious problem with established principles of preemption as applied to utility ratemaking,[3] the lower court made a distinction between approving any effort on the part of the NCUC to "reform the contracts [the Agreements] to alter the actual flow of return power [from TVA] thereunder," which it recognized would be patently unlawful, and merely permitting the NCUC to exercise discretion in "choosing between the competing jurisdiction cost allocation methodologies presented by the parties." *Id.* at 668-669.[4]

Despite the distinction drawn by the lower court, the roll-in method which it approved does produce a different allocation of entitlements to the TVA power for Nantahala and Tapoco than the allocation made by the FERC. The NCUC implicitly recognized the actual nature of its decision when it stated, candidly, that there was no need to reform the NFA because the

[3] As applied to utility ratemaking, preemption is frequently referred to as the "Naragansett Doctrine," after the often cited case of *Naragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978).

[4] Similarly, in an overly defensive statement, the North Carolina Supreme Court observed that "nothing contained in the Commission's order *purports* to change or modify a single word of the . . . agreements involved, or the actual flow of power thereunder." 313 N.C. at 688 (emphasis added).

roll-in method was "an alternative solution available" which could be used to rectify the "inequities" in the entitlements created by the Agreements.[5] The lower court's distinction amounts to a legal fiction conceived solely to avoid a collision with preemption doctrine as set forth in its opinion.

Furthermore, the North Carolina Supreme Court's analysis of the preemption cases brought to its attention is faulty and misleading in its emphasis. First, before analyzing the three most factually similar cases, the court concluded that there exists a preemption rule of general applicability to utility ratemaking which is consistent with the NCUC's decision. As stated by the court, the preemption rule "requiring state commissions to 'treat' costs based upon FERC-filed rates as reasonably incurred operating expenses, thus preventing the automatic disallowance of these costs, has not been held to preclude state authority to determine whether these costs should be automatically passed through to retail consumers in the form of higher rates." 313 N.C. at 693-694.

The court's statement of a preemption rule strains the meaning of the cases from which it is derived.[6] More significantly, the court failed to recognize that those cases involve factual situations significantly dis-

[5] *In the Matter of Application of Nantahala Power and Light Company for Authority to Adjust and Increase Its Electric Rates and Charges*, NCUC Docket No. E-13, SUB 29 [Remanded], *Order Reducing Rates and Requiring Refund*, Mimeo at 22 (Oct. 3, 1980). See Appendix to Jurisdictional Statement.

[6] The cases, beginning with *Naragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978), are discussed by the lower court at 313 N.C. 693-696.

similar to the case below. None of those cases called into question a decision on the part of a state commission to allocate power supply costs between two utilities in a manner different from a plan of allocation found just and reasonable by the FERC pursuant to its authority under the Act.[7]

Second, after shaping a narrow preemption rule on the basis of cases within a limited factual range, the court incorrectly found that the cases "upon which Nantahala and Alcoa place principal reliance . . . do not lead to a different conclusion." 313 N.C. at 696-697. Its attempt to distinguish the two *Northern States* cases, *Northern States Power Co.* v. *Minnesota Pub. Util. Comm'n,* 344 N.W.2d 374 (Minn.), *cert. denied* 104 S.Ct. 3546 (1984) and *Northern States Power Co.* v. *Hagen,* 314 N.W.2d 32 (N.D. 1981), is contrivance rather than correct reasoning. In both cases, state commissions failed to pass through in the form of higher retail rates the costs of an abandoned power generation project that had been allocated pursuant to a FERC-regulated rate schedule to utilities subject to their retail rate jurisdictions. The supreme courts of both states reversed the orders of their respective state commissions, as the lower court itself stated, "on the ground that the reasonableness of a . . . wholesale rate filed and approved by FERC cannot be relitigated in a retail rate proceeding before a state utilities commission." 313 N.C. at 697.

[7] Indeed, two of the cases involve research and development expenditures rather than costs attributable to power generation. *Pub. Serv. Co. of Colorado* v. *Pub. Util. Comm'n of Colorado,* 644 P.2d 933 (Colo. 1982), and *Washington Gas Light Co.* v. *Pub. Serv. Comm'n of the District of Columbia,* 452 A.2d 375 (D.C. App. 1982), *cert. denied,* 462 U.S. 1107 (1983).

The court implicitly recognized that the *Northern States* cases, involving a cost allocation plan established by the FERC for a power generation project, are directly on point. Plainly in an effort to protect retail ratepayers within North Carolina from higher rates at the expense of an out-of-state ratepayer, however, the court contrived the distinction that such cases prohibit only a direct disallowance of costs allocated according to a FERC-regulated rate schedule, whereas the NCUC "did not disallow any of the system costs incurred by both Nantahala and Tapoco under the NFA and 1971 Apportionment Agreement in determining the aggregate rate base and operating expenses of the rolled-in system." 313 N.C. at 698. Elaborating, the court stated that, "*all costs* attributable to Nantahala and Tapoco were *recognized and allowed* by the roll-in; the difference between 'book' costs and 'reasonable' costs resulting from the Commission's discretionary determination that only a certain percentage of Nantahala's book costs were incurred in serving the combined system's intrastate retail customers." *Id.* at 698.

Irrespective of the court's view, it is inescapable from the point of view of Nantahala that some of its "book" costs of power generation allocated to it pursuant to the FERC-regulated Agreements were disallowed by the NCUC. Thus, as a result of the so-called roll-in method, Nantahala's retail customers, all of whom are located in North Carolina, will not pay for Nantahala's production and purchased power costs in the same proportion that they would have if the NCUC had respected the FERC-regulated Agreements; and Alcoa's plant in Tennessee will incur responsibility for the difference.

If Tapoco were located just across the state line in Tennessee and both it and Nantahala were owned by a parent company which, unlike Alcoa, derived substantially all its revenues from their retail rates, the result of this cost shifting could be more disastrous. If Tennessee's state commission, exercising its jurisdiction over Tapoco's retail rates,[8] made a similar "discretionary determination that only a certain percentage of [Tapoco's] book costs were incurred in serving the combined system's intrastate retail customers," the two utilities and their parent would be caught in the middle, as neither utility would be allowed to recover its cost of service. The FERC lacks the power to order state commissions to permit recovery through retail rates of FERC-approved wholesale rates. Therefore, absent protection by the courts through enforcement of a sound preemption rule, the ability of Nantahala and Tapoco to render service to their customers would be impaired.

The court relied on the observation that all production costs attributed to a combined Nantahala-Tapoco system "were *recognized* and *allowed*" to avoid the problem of cost shifting caused by the NCUC's order. That reliance is dependent in large part on the validity of the lower court's determination to "pierce the corporate veil" and treat the two affiliated companies as one. However, with regard to a case involving the pass through of power generation costs between two affiliated utilities pursuant to a FERC-regulated rate schedule, the Supreme Court of New Hampshire recently found that the issue of piercing the corporate veil is "within the FERC's domain of fixing the wholesale rate between these parties." *Sinclair Machine Products, Inc.* v. *Pub. Util. Comm'n of New Hampshire,* No. 84-380 (N.H. July 26, 1985) at 12. The court also found that the "modern trend"[9] in applying the preemption doctrine to state regulation of retail electric rates is to preempt the state from considering matters actually determined, whether expressly or impliedly, by the FERC. *Id.* at 7. As discussed, the FERC, in deciding not to adopt a roll-in method, expressly rejected the argument that it should pierce the corporate veil between Nantahala and Tapoco.[10]

[8] More typically, Tapoco might have a mix of customers similar to Nantahala's.

The lower court's treatment of *Office of Pub. Counsellor* v. *Indiana and Michigan Electric Co.,* 416 N.E.2d 161 (Ind. App. 1981) is also unconvincing. Here again,

[9] The court's reference to a "modern trend" reflects some decisions in lower courts and various regulatory agencies which may be perceived as creating an exception to the rule requiring a state commission to treat FERC-regulated rates as reasonable expenses. *Id.* at 7. *See, e.g., Pike County Light and Power Co.* v. *Pennsylvania Pub. Util. Comm'n,* 465 A.2d 735 (Pa. Commw. Ct. 1983). The exception, if valid, would permit a state commission to consider the prudence of a utility's decision to make a purchase under FERC-regulated rates in light of other power supply options available to the utility. The decision below does not expressly or impliedly turn on an exception, if any, of this type because the prudence of Nantahala's power supply arrangements is not questioned.

[10] *Accord, United Gas Corp.* v. *Mississippi Pub. Serv. Comm'n,* 240 Miss. 405, 127 So.2d 404 (1961), wherein the Supreme Court of Mississippi rejected the view of the state's retail ratemaking commission that, because the interstate and intrastate companies were affiliated, the commission could disregard the FPC [predecessor to the FERC] rates. ("There is nothing to suggest that the FPC will not closely scrutinize this relationship, for the statutory purpose of protecting the public and consumers from exploitation.")

the case involves an allocation of power generation costs pursuant to a FERC-regulated rate schedule in the context of a retail rate proceeding before the appropriate state commission. Moreover, the device used by the state commission to alter the level of costs allocated pursuant to the FERC regulated rate schedule was a roll-in of the generation resources of two separate corporate identities. The Indiana Court of Appeals struck down the state commission's roll-in, as summarized by the court below, because it constituted "an impermissible collateral attack on the authority of the FERC." 313 N.C. at 699.[11] Once more, however, the lower court offered the faulty explanation that the NCUC's roll-in was different because it did not result in a disallowance of Nantahala and Tapoco's combined generation costs. Then, it stated that, "Moreover, it is obvious that the 'roll-in' attempted by the Indiana Commission entailed a far more direct intrusion into FERC's regulatory domain . . . ." *Id.* at 700.

The lower court's statement carries the implication that the NCUC has intruded on the FERC's authority. The court's distinction between a "far more direct intrusion" and presumably an intrusion of ordinary dimensions should not be accepted. *Federal Power Comm'n* v. *Southern California Edison Co.*, 376 U.S. 205, 215-216 (1964). ("Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction making unnecessary . . . case-by-case analysis.") Regardless of the lower court's subjective view of the degree of severity, federal preemption precludes that intrusion.

---

[11] *Accord, Sinclair Machine Products*, No. 84-380 (N.H. July 26, 1985).

Furthermore, the lower court's rejection of federal preemption arguments on the grounds that the FERC itself adjusted the 1971 Apportionment Agreement (313 N.C. at 693, 703-710) is plainly poor reasoning; and in finding the NCUC's "ratemaking methodology to be consistent with FERC's own actions in the parallel wholesale rate case" (*Id.* at 703), the court took much liberty since the FERC did not adopt anything resembling the NCUC's cost allocation method. The FERC's modification of the allocation plan embodied in the 1971 Apportionment Agreement represents a proper exercise of its authority under the Act to ensure that rate schedules subject to its jurisdiction are just and reasonable. By carrying out that duty, the FERC did not open the way for the NCUC to bypass the doctrine of federal preemption; otherwise, federal preemption would become an intolerable constraint under the FERC in attempting to perform its duties. In any event, although the FERC did adjust the 1971 Apportionment Agreement, the adjustment made by the FERC is radically different from the NCUC's cost allocation method.

In summary, in finding that the NCUC's order did not violate federal preemption, the decision of the North Carolina Supreme Court is inconsistent with preemption doctrine as applied by the supreme courts of the states of Minnesota and North Dakota and by the state of Indiana's court of appeals in cases far more similar to the case below than any other preemption cases decided by courts to date. If allowed to stand, the decision could imperil the electric utility industry's reliance on FERC-regulated power supply contracts to meet large portions of the nation's demand for electrical power.

III. The Decision Below Violates The Prohibition Against Undue Interference With Interstate Commerce.

Unlike precedent on the preemption issue, which so far has been crafted by lower courts, precedent on the relationship of the Commerce Clause to the power of states to regulate the economic benefits of hydroelectric power flowing in interstate commerce is "well-settled," *Middle South Energy, Inc.* v. *Arkansas Pub. Serv. Comm'n,* Nos. 84-2409, 84-2410 and 84-2480, slip op. at 12 (8th Cir. August 23, 1985) because this Court has spoken. *New England Power Co.* v. *New Hampshire,* 455 U.S. 331, 344 n.10 (1982) (deferring resolution of preemption issue in favor of resolving Commerce Clause issue). Therefore, unlike its analysis of the preemption issue, in which the lower court was able to confuse the most significant precedent with precedent derived from similar but less meaningful circumstances, the lower court's analysis of the NCUC's decision in light of the Commerce Clause implicitly recognizes that one case, *New England Power Co., (NEPCO)*, controls. The court stated:

> We agree with the companies' contention that *NEPCO* establishes that a state utilities commission may not grant its citizens a preferred right to the benefit of hydroelectric energy generated by a utility in that state solely to gain an economic advantage over the utility's out-of-state customers, and that the granting of such a preferred benefit, regardless of how it is effectuated, places a direct and substantial burden on interstate commerce in violation of the Commerce Clause.

313 N.C. at 710.

In not agreeing with the assertion "that the rule announced in *NEPCO* invalidates the action of the Commission in this case" (*Id.* at 710), however, the lower court resorted to the same, superficial form of distinction it drew with respect to the *Northern States* cases and *Office of Public Counsellor* v. *Indiana and Michigan Electric Co.* The court noted:

> However, unlike the action of the New Hampshire commission, the roll-in performed by the Commission in this case does not *purport* to prohibit the exportation of energy produced within North Carolina, nor does it divert the flow of Tapoco's power to Nantahala. More importantly, the roll-in methodology used by the Commission does not exclusively reserve to the citizens of North Carolina the entire economic benefit of the unified system's low-cost in-state hydroelectric generation.

313 N.C. at 712-713 (emphasis added).

The court's reliance on its interpretation of the New Hampshire Commission's order as purporting to prohibit the exportation of hydroelectric power produced within New Hampshire is insufficient. In *NEPCO,* this Court decided the Commerce Clause issue knowing that, "[t]he Commission did not, however, order New England Power to sever its connections with the Power Pool." *NEPCO* at 336. Moreover, *NEPCO* is clearly premised on recognition that:

> So long as the electricity produced at New England Power's hydroelectric plants continues to flow through the Pool's regional transmission network, it will be impossible to contain that electricity within the State of New Hampshire in any physical sense. Although the precise contours of the Commission's order are unclear, it appears to require that New England Power sell electricity to New Hampshire utilities in an amount equal to the output of its in-state hydroelectric facilities, at

special rates adjusted to reflect the entire savings attributable to the low-cost hydroelectric generation.

Id. at 336 (footnote omitted).

Thus, although the order of the New Hampshire Commission was cast in terms of prohibiting the export of hydroelectric power outside the state, *NEPCO* invalidates "protectionist regulation" (*Id.* at 339) taking the form of special rates as well as an order overtly blocking the flow of interstate commerce at a state's borders.

Indeed, finding *NEPCO* dispositive, the United States Court of Appeals for the Eighth Circuit recently affirmed the judgment of the district court enjoining the Arkansas Public Service Commission (APSC) from even continuing a show cause proceeding, aimed at protecting the citizens of Arkansas from a wholesale rate increase, although the state's attorney general argued that there was no significant burden on interstate commerce because "the APSC has only issued a show cause order, and not actually voided the contracts in issue." *Middle South Energy, Inc.* v. *Arkansas Pub. Serv. Comm'n,* Nos. 84-2409, 84-2410 and 84-2480, slip op. at 13 (8th Cir. August 23, 1985). Furthermore, while the APSC sought to cancel agreements at issue "ostensibly because they have not received the necessary state regulatory approval," the court saw that the APSC's actual concern was economic protection of its citizens and that this protection was to be achieved at the expense of citizens of other states. *Middle South Energy,* slip op. at 22-23 ("Given free rein, the APSC would shift this burden [wholesale rate increase pursuant to the Act] to the citizens of Mississippi and Louisiana, citizens who are powerless to directly influence Arkansas' internal affairs.") In this case, it is also "abundantly plain" (*Id.,* slip op. at 22) that the NCUC's concern is to protect Nantahala's general service customers by shifting the burden of a rate increase to another state.

The lower court also fails in its attempt to distinguish *NEPCO* on the ground that the NCUC's cost allocation method "does not exclusively reserve to the citizens of North Carolina the entire economic benefit of the unified system's low-cost in-state hydroelectric generation." The NCUC characterized the cost allocation method chosen by it as one which assumed that Nantahala's public load had a "first call on the total electric energy output of the combined Nantahala-Tapoco system." 313 N.C. at 714. The court contends, however, that a complete reading of the NCUC's order shows that the NCUC's "initial characterization" of its method as creating a "first call" was in error. *Id.* at 715. Accepting the court's interpretation of the NCUC's order for the sake of argument, the fact remains that, for the reason explained in the Jurisdictional Statement,[12] the order has the effect of giving Nantahala's customers a first call on the cheaper hydroelectric power. In turn, this requires Tapoco to take more expensive power to serve Alcoa's plant in Tennessee.

The order is, therefore, an act of simple economic protectionism that is *per se* unlawful under *NEPCO.* The lower court's attempt to characterize the NCUC's order as "even-handed" regulation of the type upheld in *Arkansas Electric Cooperative Corp.* v. *Arkansas Pub. Serv. Comm'n,* 461 U.S. 375 (1983), is inadequate.

---

[12] As explained therein, the operative factor is the use of assumed entitlements that exceed actual entitlements under the NFA.

There the choice confronting this Court was between regulation of the cooperative's wholesale rates by the APSC or no regulation in view of the Federal Power Commission's (now the FERC) earlier determination that it lacked jurisdiction over such rates under the Act. The Court's affirmance of the APSC's assertion of jurisdiction by the APSC over otherwise unregulated rates, notwithstanding that the cooperative was tied to the interstate grid, on the basis of a balancing test is plainly different. There was not a hint of discriminatory, economic protection at work in that case.

Furthermore, the bare facts that "the setting of retail electric rates for Nantahala's customers is clearly a legitimate North Carolina interest with a significant impact in this state", and that the price charged to Nantahala's retail customers may have only a *"de minimis"* effect on the "interstate 'grid' " (313 N.C. at 717), do not entitle North Carolina to a more lenient balancing test applied in that case for facially neutral economic regulation. In *NEPCO,* this Court could have applied a similar rationale to uphold the New Hampshire Commission's order since New Hampshire clearly has an interest in keeping electric rates within its borders as low as lawfully possible. Thus, the lower court's effort to distinguish *NEPCO* fails and the decision should not stand.

CONCLUSION

The Court should note probable jurisdiction.

Respectfully submitted,

ROBERT L. BAUM
Counsel of Record
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-7400

RICHARD M. MERRIMAN
ROBERT S. WATERS
Suite 1100
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-0100

Attorneys for Edison Electric Institute

Of Counsel:

REID & PRIEST

October 1985